



In the first communication dated July 2005, there was a short paragraph on the Department of Industrial Accidents' (DIA) program of on-going audit of books and records. The short paragraph generated some interest and questions. Because of the interest generated, the DIA will devote this communication to this topic.

On-going Audit of Books and Records

The DIA, under the authority of the Massachusetts General Law, Chapter 152, will be conducting reviews of the books and records of all Massachusetts Workers' Compensation insurance carriers in order to determine compliance with this statute. This review will be conducted to verify the accuracy of the assessments collected from employers and forwarded to the DIA.

The authority is noted in Chapter 152, Section 65, Paragraph 12, where it is stated:

The commissioner shall supervise, monitor and establish procedures for all aspects of the assessment of insured and self-insured employers and self-insurance groups including but not limited to the proper reporting of base amounts; the determination of proper assessment rates; the calculation, billing and

collection of assessment payments; proper accounting; reporting and transmittal by insurers of assessment payments by insured employers; and all other matters necessary to assure proper compliance with this section; and may issue regulations and conduct hearings for this purpose. He also shall establish procedures for the review and adjudication of grievances by employers with respect to the propriety and accuracy of assessed payment.

In order to carry out this mandate, the DIA has entered into an agreement with the public accounting firms of Parent, McLaughlin & Nangle Certified Public Accountants, Inc. and Moody, Famiglietti & Andronico, LLP to act as its agents in this capacity. You may be contacted by one of the firms to arrange time for the review.

The DIA expects full cooperation with these agents during their review of the insurance company records.



History – Phase I

In 1999, the DIA contracted with three accounting firms to perform a review of the assessments remitted by the insurance companies. The objective of

the review was to ensure that proper and accurate assessments were collected from policyholders and then remitted to the Commonwealth of Massachusetts. As noted above, the DIA has elected to continue with the services of Parent, McLaughlin & Nangle, Certified Public Accountants, Inc. and Moody, Famiglietti & Andronico, LLP.

Current Reviews – Phase II

The DIA begins a new round of reviews focused upon an review period from January 1, 1999 to December 31, 2003 unless an audit was previously completed, in which case, the audit will continue from where the previous audit concluded. Each review is expected to be completed within four to six months. This is an aggressive plan, taking advantage of the previous experience, audit programs and company contacts developed by the two accounting firms. The DIA expects that the majority of insurance companies will be included in this phase of reviews, which will extend to late 2006. The review criteria are noted below.



Future phases – Phase III

Following the completion of Phase II, the next phase of reviews will be more current, covering the current period. The next round of audits could begin as early as the first quarter of 2007.

It is the DIA's goal to become less reliant upon accounting firms for these reviews. At present, it is anticipated that DIA staff will conduct the majority of reviews, with fewer more focused audits contracted to accounting firms. In order for the DIA to be in a position to take on this responsibility, internal processes will need to be developed and external partnerships established with the Workers' Compensation Rating and Inspection Bureau (WCRIB), the Division of Insurance and the insurance industry.

Review Procedures

The review procedures established by the DIA for the contracted accounting firms consist of five (5) general categories.

The first procedure tests the insurance company's compliance with the assessment rates for both public and private employers. The accounting firm typically requests that the insurance company produce a list of all standard premiums and related assessments due for each quarter within the audit period. Next, the accounting firm reconciles the total insurance premiums and assessments listed on the quarterly insurer provided audit reports to the amounts listed on the DIA Form 50.

The accounting firm will then select random policies for testing. The accounting firm tests each transaction and verifies the following:

- the back-up documentation (which should be the final policy) properly foots;
- the amounts included on each item of back-up documentation are properly

calculated (correct multiplication of components);

- the classification rates used agree with the approved rates as published in the Massachusetts Workers' Compensation & Employers Liability Manual;
- the experience modification rate used agrees to the rate established by the Commonwealth for that employer during that time period;
- the DIA assessment rate used agrees to the assessment rate established by the DIA during the corresponding time period.

The second procedure tests the insurer's compliance with the standard premium as defined by the DIA. This involves verifying that the assessment calculated by the insurance company is based on DIA definition of standard premium, which follows:

Standard Workers' Compensation Premium, as used in M.G.L. c. 152, Sec. 65 and 452 CMR 7.00, shall mean the direct written premium equal to the product of payroll by class code and the currently applicable manual rates multiplied by any applicable experience modification factor.

The third procedure tests the insurance company's collection of assessments from all employers pursuant to M.G.L. c. 152, Section 65. In some instances, this criterion is not relevant because the insurance company remits assessments based on premiums written rather than assessments collected.

The fourth procedure tests the insurer's compliance with the collection of assessments from employers and the proper application of credit adjustments to the assessments pursuant to M.G.L. c. 152, Section 65. Again, in some instances, this criterion is not relevant because the insurance company remits assessments based on premiums written rather than assessments collected.

The fifth procedure tests the insurer's compliance with payment of all funds collected by the insurer that are due to the Department. This involves verifying that checks written to the Department agree with the Form 50s and that quarterly payment of assessments were made within thirty (30) days of the respective invoice dates.

In some instances, the accounting firm will perform additional tests as warranted by its findings. These tests are discussed with the DIA on a case-by-case basis.



Issues from Prior Reviews

The first reviews have been completed. The DIA has reviewed the audit reports issued; the following is a brief summary of the main audit findings.

Deviated premiums – companies based the assessment on deviated classification rates, which is incorrect. The assessment is based upon DIA standard premium using approved rates prior to

the effects of any company deviations or discounts to the premium.

Scheduled Credits – companies based the assessment on the premium that included scheduled credits. The assessment is based upon standard premium, prior to the effects of scheduled credits or other deductible credits.

Massachusetts Construction Credit Program – companies included this program in the calculation of the standard premium. The DIA assessment is based upon the standard premium prior to the deduction of this program credit.

Experience Modification Factor - companies used an incorrect experience mod, or were unable to provide documentation to support the calculation

Wrong Assessment Rate – companies used the incorrect assessment rate. Typically the rate was for the incorrect period or private and public rates were incorrectly used.

What the Insurance Company can Expect

The DIA requested the two review firms to provide an outline of their approach to completing these reviews. The DIA is including their responses in this communication so that the review process can be completed in a timely manner, with little interruption to the companies' ongoing operations.

Each review firm will make initial contact to the insurance company. This will usually be made to a contact from previous audit work performed or to the

individual designated by the insurance company and copied on the audit notification letter from the DIA advising the insurance company of the review.

Next the reviewing firm will send the insurance company a letter requesting the following information:

- Annual audited financial statements;
- Annual report filed with the Massachusetts Department of Insurance (or selected pages there from);
- Write up of accounting policies and procedures relevant to preparation of the Form 50s;
- Contact people involved in preparation of the Form 50s and in the company's underwriting department;
- Copies of the Form 50s;
- Work papers or other source listings supporting amounts (assessments and premiums) reported on the Form 50s;
- Detail listings of Massachusetts's workers' compensation policies for each of the audit periods. Listings should include policy number, effective date, written premium, and standard premium;
- Copies of cancelled checks used to pay the assessments.

The policy listings are reconciled to the Form 50s and annual reports and are used to select a sample of policies to be tested for proper calculation of the assessment. The insurance company would be asked to provide the policies and support for the related experience

modification rates for inspection by the auditors.

Errors found in the sample will be extrapolated by the firms to calculate additional assessments and or overpayments.



Suggestions for Expediting the Review Process

The following are suggestions from the review firms to help expedite the review:

- Have a representative of the underwriting department available while detail testing is taking place to answer the auditor's questions on the assessment calculations.
- Establish reasonable dates for providing the information requested and commit to those dates.
- Prepare in advance for the process of having to locate policies that were in effect during the audit period specified.
- Provide listing in electronic format.
- Be sure to provide final audited policies when applicable
- When pulling policies for support, reconcile any differences and provide a copy of such reconciliation with the policy to the auditing firm.
- Reconcile to the Form 50s ahead of time.
- If errors are identified with respect to assessments calculated or

payments made internally, provide any analysis related to these findings as early as possible.

- If amendments to the original filings are identified, please provide the original documentation along with the amended documentation of the assessment calculations.

Contact persons should be committed to completing the process in an efficient manner and should be knowledgeable in the areas being tested.

DIA Contact Information

Assessment Manager James Boyle has been designated as the point of contact for insurance companies at the DIA. All questions or comments regarding the assessment process should be directed to him.

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August 2005

